Fiscal Year 2015 Q1 Financial Results Conference Call Transcript
November 13, 2014
1:30 p.m. PST (4:30 p.m. EST)

Operator: Greetings and welcome to the Pro-Dex Fiscal 2015 First Quarter Results Conference call. At this time, all participants are in a listen-only mode. Question-and-answer session will follow the formal presentation. As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Mr. Hal Hurwitz, CEO.

Hal Hurwitz, Chief Executive Officer, Pro-Dex, Inc.: Thank you, John, and thank you all for joining us to review the results for the Fiscal 2015 First Quarter Ended September 30, 2014. On today's call, I will provide a synopsis of our operating results as well as some comments. Then, as John mentioned, we will open up the call for your questions.

Before beginning, however, I ask our participants and listeners to note that the comments made on this call may include statements that are forward-looking within the meaning of Securities laws. These forward-looking statements may include, without limitation, statements related to anticipated industry trends and the company's plans, products, prospects and strategies, both preliminary and projected. Actual results or trends could differ materially. We undertake no obligation to revise forward-looking statements in light of new information or future events. For more information, please refer to the risk factors discussed in the Company's Form 10-K for the year ended June 30, 2014, which has been filed with the SEC; the Form 10-Q for the quarter ended September 30, 2014 filed with the SEC today; as well as to the Form 8-K filed with the SEC today, along with the attached press release issued today, all of which can be obtained from the SEC or by visiting our website at www.pro-dex.com.

Now, let's cover the quarter results. Net sales for the three months ended September 30, 2014 were $2.6 million, an increase of 2% from $2.5 million for the three months ended September 30, 2013. Underlying these relatively stable year-over-year sales levels was a $400,000 increase in sales to the Company's largest medical customer, partially offset by a $183,000 decrease in repair revenue from the Company's former largest medical device customer and a $151,000 decrease in sales to another customer. The growth in sales to the Company's largest customer arose from the resumption of shipments to this customer in December 2013, following its suspension of orders from March through November 2013, ostensibly to relieve an inventory buildup of the Company's product.

Gross profit for the three months ended September 30, 2014 decreased $117,000, or 12%, to $828,000 compared to $945,000 for the year-ago period, primarily due to a shift in product mix between periods in which there were comparatively reduced volumes of high-margin product repairs and increased volumes of relatively lower margin product sales. Also contributing to the reduced gross profit between the periods were increases in accruals for anticipated losses on the fixed price product development services portion of certain contracts, and in under-absorbed manufacturing costs due to reduced manufacturing volumes in the quarter ended September 30, 2014, compared to the corresponding year-earlier period.

Partially offsetting these increases was a decrease in inventory and warranty charges for the quarter ended September 30, 2014, compared to the corresponding quarter of the prior fiscal year, due primarily to a downward revision in estimated per-unit repair costs. The net increase in charges and accruals I described also contributed to a decrease in gross margin as a percentage of sales, which declined to 32% for the three months ended September 30, 2014 from 37% for the corresponding year-ago period.

Operating expenses, which include selling, general and administrative, and research and development expenses for the quarter ended September 30, 2014 increased 10% to $1 million from $924,000 in the prior year's corresponding quarter, reflecting primarily increases in business development expenses and project-related legal costs. Loss from continuing operations for the quarter ended September 30, 2014 was $181,000, compared to income from continuing operations of $18,000 in the prior year's corresponding quarter. Net loss for the quarter ended September 30, 2014 was $170,000, or $0.04 per share, compared to net income of $212,000, or $0.06 per share, for the corresponding prior-year period. It should be noted however, that net income for the quarter ended September 30, 2013 included a $167,000 gain from the sale of the Company's former Carson City facility, which is reflected in the results of discontinued operations for that period.

With all of this said, now some brief commentary, a surface-level comparison of our results for the quarter ended September 30, 2014 to the year-earlier period will not do justice to the Pro-Dex narrative. Last year, we were enduring a suspension in product orders from our largest customer, thus repair revenues represented an abnormally large portion of that quarter's revenues. Because repair orders typically carry a higher gross margin as a percentage of sales, the prior year quarter's results benefitted from those circumstances. By contrast, this year, with the resumption of product shipments to our largest customer, the mix of revenues was more typical, albeit comparatively less profitable, because product sales do not carry as high a gross margin percentage as do repair orders.

On balance, we obviously prefer this year's circumstances, the resumption of product sales and the receipt of follow-on frame contracts from our largest customer and the expected commencement of additional product sales when the development projects currently in their final testing phases enter commercialization later in this current fiscal year. In addition, we marked the third consecutive quarter of positive cash flow from operations. Over the past three quarters, our operations have generated cash flow of $840,000.

Finally, we are excited about the prospects of our new Engineering Services Division, the launch of which we announced last week and through which we offer engineering consulting and placement services. In addition to the revenue enhancement we expect through this new service offering, we believe it has synergistic potential to augment our Company-wide business development effort.

I am now happy to invite any questions you might have with regard to the quarter or our business operations. To that end, I'll turn the call back over to John for Q&A.

Operator: Our first question comes from the line of Matthew Melchione, a private investor.

<Q – Matthew Melchione>: I've only got a handful questions. I'm just wondering if you can provide us a bit of an update on the product development project and how the testing phase is proceeding. It sounds like you said that you're in the final stages of that, but just an update on the potential timeline there?

<A – Hal Hurwitz, CEO>: Sure. I think in the past I've been fairly general with the timelines other than to say that we do expect to enter the manufacturing and product shipment phase within this fiscal year and that's still the outlook. We are in what I would characterize is our final phase of testing. You're right; albeit, that phase is a lengthy phase. So we are getting through it, and as I say, we do look forward to product shipments within the current fiscal year.

<Q – Matthew Melchione>: I have a few questions and I am not sure how much of this you can disclose on the repurchase plan. I noted that in the proxy statement, it showed a slight dip down in the outstanding shares. I was wondering if you could give an update as to how many shares have been repurchased up to this point in the quarter.

<A – Hal Hurwitz, CEO>: Yes, there haven't been an appreciable number of shares repurchased, probably— I have someone looking at it right now but I don't think it's been all that appreciable. So, it's been 41,000— a little better than 41,000 shares that have been repurchased so far.

<Q – Matthew Melchione>: And then the total amount wasn't stated in the announcement, but you're using the 750,000 repurchased plan that you discussed a few years back? Is that the total amount that you can repurchase?

<A – Hal Hurwitz, CEO>: That's the total amount that had been approved by the board a year ago. The plan under which we're currently repurchasing is not for that entire amount. We have not disclosed the details of the plan that we're currently under but I think it's safe to say, it's not near that total amount.

<Q – Matthew Melchione>: There is no issues with tax implications on the net operating losses or anything?

<A – Hal Hurwitz, CEO>: That's correct.

<Q – Matthew Melchione>: Then, just can you give an overview of this new division? How large should we expect it to be part as part of the overall operating performance of the firm? Is it going to be sizable or is it something that's an additional service that you can just add-on to the product offering, and when will we start seeing the results of that?

<A – Hal Hurwitz, CEO>: Well, in terms of characterizing its potential significance, one has to look at in two ways, but either way, I won't get into sizable or not sizable, but I will say that I think it will be noticeable. That's really for two reasons. One is we believe that this division is capable of generating on its own through placement services, noticeable revenues, especially to the run rate we are now at, and obviously we look to increase that run rate. Even without the division, we would have looked to increase the run rate but we certainly see this as being additive to our efforts.

But we also see a synergistic effect as well, because of the engineering talent we have in the Company and the commonality of the contact base that our General Manager, Marvin Gidney, of the new

Engineering Services Division, has with our VP of Engineering. We look for a lot of synergistic effect there, and talking to companies that have a need. And being able to offer to companies a menu of services, be it placements of engineers on a contract basis, or be it something that might develop into consulting services that we can render from our in-house staff. So from a variety of perspectives, we view this service line of business as being a noticeable addition to our effort.

Operator: Mr. Hurwitz, it seems to be no further at this time. Would you like to make any closing remarks?

<A – Hal Hurwitz, CEO>: Thank you, John, and thank you, everyone, for joining us today. All of us at Pro-Dex appreciate your interest, your time, and your support of the Company, and we look forward to speaking with you in February when we report our fiscal year 2015 second quarter and first half financial results. Thank you.